United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

(42244)

ORIGINAL

75-5005

To be argued by
SAMUEL J. WARMS

United States Court of Appeals

FOR THE SECOND CIRCUIT

Case No. 75-5005

In the Matter

—of—

AVIEN, INC.,

Debtor.

THE CITY OF NEW YORK,

Appellant,

—against—

AVIEN, INC.,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

BRIEF OF APPELLANT THE CITY OF NEW YORK

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The net operating loss deduction for the City tax is the federal deduction modified by the provisions of paragraph (f) of subdivision 8 of Section R46-2.0 of the Administrative Code. That subdivision requires the use of the same loss year or years which may be used in the calculation of the federal income tax with the elimination of those of them during which the taxpayer was not subject to City tax. Section 172 of the Internal Revenue Code requires that the federal net operating loss deduc-

CASES CITED

Statutes Cited

AUTHORITIES CITED

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Statement

This is an appeal by the City of New York (hereinafter referred to as "the City") from an order of the United States District Court, Eastern District of New York (Neaher, D.J.), dated March 10, 1975 (53a-66a).*

* Unless otherwise indicated, references are to pages of the appendix to this brief.

The order affirmed the decision of the Bankruptcy Judge (43a-52a) which had expunged the City's claim for General Corporation Tax imposed by Administrative Code of the City of New York, Title R, Part II, for the debtor's taxable year ending June 30, 1968.

Questions Involved

The questions raised on this appeal are:

1. Whether a taxpayer which is concededly barred by provisions of the City's General Corporation Tax Law from including in its net operating loss deduction losses incurred in years during which it was not subject to that General Corporation Tax, may substitute for those barred losses, losses carried from other years which were not and may not be used* in the calculation of its federal net operating loss deduction for the taxable year involved.

2. Are the net operating losses of several years required under Internal Revenue Code §172 to be carried back and carried over in the chronological order of the years in which they are incurred or may a later year's loss be used before earlier losses are consumed in reduction of the income earned in the years to which they may be carried?

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* Whether they may not be so used is the subject of the other question involved, for the Court below held the taxpayer might have even chosen to substitute the later loss years in its federal return (61a) and that this might be accomplished by amending its 1968 federal return (*id.* f.n. 5). This notion, we shall later show, supported by but one U.S. District Court opinion, is contrary to the holdings of this Court, the overwhelming majority of federal cases and rulings on the subject and accurate statutory analysis.

The Facts

The debtor filed its petition for arraignment in the court below on December 24, 1970 (67a). On or about August 17, 1973, the City of New York filed a second amended proof of claim for taxes in the sum of $19,567.16 (14a-16a, 69a). Of this amount, all but $17,789.32 for general corporation taxes is conceded (69a). The general corporation tax for taxpayer's fiscal year which ended on June 30, 1968, is the only subject of this appeal. The debtor had, by petition dated June 22, 1973 (8a-13a), and notice of motion dated July 3, 1973 (6a-7a), moved to expunge and reduce the claims of the City of New York. Although the amended claim in issue was filed after that motion, it was stipulated that the motion be deemed to refer to the amended claim (20a-21a).

The taxpayer's general corporation tax return for fiscal 1967-1968* showed net income before deduction of net operating loss, of $286,969.82 (54a). Its federal return for the same period showed taxable income before net operating loss deduction, of $282,598.52 (67a).** This figure was reduced to zero by a net operating loss deduction of identical amount carried forward from taxpayer's 1963 year, in which year it sustained a net loss of $762,423.73 (*ibid.*). Taxpayer sustained operating losses in 1966 and filed federal returns claiming losses for 1969 and 1970, which exceeded its 1968 taxable income before deduction

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* The taxpayer's fiscal, and hence taxable, years were those ending on June 30. For the sake of brevity, we denominate those years hereafter, by the years in which they ended.

** The difference in the city and federal figures is due to modifications of the federal figure dictated by Administrative Code §R46-2.0, subdivision (8), *infra*, pp. 10-14.

of any net operating loss (67a, 25a-28a, 55a). It deducted in its City return for 1968 the amount shown as the operating loss deduction on its federal return for that year (30a, 72a).

The Federal Net Operating Loss Deduction

Despite a contrary holding below, we believe that the following description accurately sums up the mechanics of the federal net operating loss deduction.

The net operating loss deduction provided by Internal Revenue Code Section 172 is a combination of loss carryovers and loss carrybacks. The operating loss for a given year may be carried back for three years to the third year preceding the year of loss. The unused portion is then carried back to the second year preceding the loss and any remaining unused portion is carried to the year immediately prior to the loss year. Any portion still remaining may be carried forward for as many as five years after the year of loss. However, the aggregate net operating loss deduction will frequently consist of the losses or parts of the losses of more than one year. These are segregated and the earliest of them is first employed in a carryback to the third year preceding the year of loss. Only after the earliest of the losses has been consumed by being carried back and/or forward do the later loss years come into play in chronological order. It is only when the earliest loss has been fully used up or expired by remoteness that a later year's loss becomes operative.

The City Tax Structure

The base for computing New York City corporation income tax is "entire net income." "Entire net income"

is defined as "the same as" the taxpayer's federal taxable income with certain exceptions and modifications. Subdivision 8 of §R46-2.0 of the Administrative Code of the City of New York states that "'entire net income' means net income from all sources which shall be the same as the taxpayer's federal taxable income * * * except as hereinafter provided." Thus, the starting point for calculating "entire net income" is federal taxable income and that term, defined by federal law, already includes the deduction for the net operating loss carrybacks and carryovers provided for by Section 172 of the Internal Revenue Code. For federal taxable income is defined by Section 63 of the Internal Revenue Code as "gross income minus the deductions allowed by this chapter * * *." Among those deductions is that provided by Section 172 for net operating losses. At the outset, therefore, the taxpayer's "entire net income" includes a deduction for its net operating loss carrybacks and carryovers. Later provisions of subdivision 8 of §R46-2.0, paragraphs (a) to (i), call for modifications of the taxpayer's federal taxable income. One of these provisions, paragraph (f) of subdivision 8, provides for modification of the federal net operating loss deduction. In doing so, it reiterates the right to take such a deduction but provides that any net operating loss shall be increased or decreased to reflect certain modifications provided for by paragraphs (a), (b), (g) and (h). It further modifies the deduction by providing that any net operating losses sustained during any taxable year in which the taxpayer was not subject to City corporate income tax shall not be included in the calculation of the net operating loss. But it does not say that when the losses of those years are eliminated, they may be sup-

planted by losses of other years. Because the modifications required by paragraphs (a), (d) and (h) may increase the federal loss deduction, paragraph (f) also provides that the modified net operating loss deduction shall not exceed the federal deduction.

The Parties' Disparate Calculations

In this case, the taxpayer's federal taxable income for the year involved, 1968, before its net operating loss deduction, was $282,598.52 (72a). It had an aggregate net operating loss deduction of $1,893,063.73, of which $742,677.94 related to its net operating loss for its taxable period ending June 30, 1963 (68a). Because the available 1963 loss was more than sufficient to wipe out taxpayer's taxable income computed without the net operating loss deduction, $282,598.52 of the 1963 loss was consumed in calculating federal taxable income. Because the City tax law expressly provides that losses for taxable years in which the taxpayer was not subject to City tax shall be excluded in calculating net operating loss deductions and because there was no City tax for the year 1963,* the City, in calculating the claim in issue, disallowed any net operating loss deduction. The debtor, on the other hand, claimed that it was entitled to substitute for the barred 1963 loss, losses from later years during which the debtor was subject to New York City taxes. It claimed the right to do this even though the starting point for calculating its City "entire net income" was its federal taxable income and even though losses for the later years which it claimed

* Not only pre-1966 losses are excluded. Losses from years in which taxpayers operated only outside the City are also excluded. Consequently, the problem presented by this case is not ephemeral, but continuing.

to be able to take were not, in our view, deductible in calculating its federal taxable income.

It also claims that neither the definition of "entire net income" nor paragraph (f) of subdivision 8 of §R46-2.0 requires the use of the actual federal loss deduction figures, appropriately modified, but that subdivision (f) merely adverts to Internal Revenue Code Section 172 as setting forth the principles and method upon which it can calculate the net operating loss deduction mentioned in paragraph (f), and for general guidance in calculating that deduction.

Statutes Involved

The Federal Law

The Internal Revenue Code, in Section 61, defines "gross income." Section 63, subdivision (a), of that Code, defines "taxable income" and reads as follows:

> "(a) General rule.—Except as provided in subsection (b), for purposes of this subtitle the term 'taxable income' means gross income, minus the deductions allowed by this chapter, other than the standard deduction allowed by part IV * * * ."

Among the deductions allowed by Chapter 1 (referred to in Section 63 as "this chapter"), is the deduction provided by Section 172 of the Code as the net operating loss deduction. Section 172 reads, so far as pertinent, as follows:

> "(a) Deduction Allowed.—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carry-

backs to such year. For purposes of this subtitle, the term 'net operating loss deduction' means the deduction allowed by this subsection.

(b) Net Operating Loss Carrybacks and Carryovers.—

(1) Years to which loss may be carried.—

(A)(i) Except as provided in clause (ii) and in subparagraphs (D), (E), (F), and (G), a net operating loss for any taxable year ending after December 31, 1957, shall be a net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss.

* * * * *

(B) Except as provided in subparagraphs (C), (D), and (E), a net operating loss for any taxable year ending after December 31, 1955, shall be a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

* * * * *

(2) Amount of carrybacks and carryovers.—Except as provided in subsections (i) and (j), *the entire amount of the net operating loss for any taxable year (hereinafter in this section referred to as the 'loss year') shall be carried to the earliest of the taxable years to which (by reason of paragraph (1)) such loss may be carried.* The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss

may be carried. For purposes of the preceding sentence, the taxable income for any such prior taxable year shall be computed—

(A) with the modifications specified in subsection (d) *other than paragraphs (1),* (4), and (6) thereof; and

(B) by determining the amount of the net operating loss deduction—

(i) *without regard to the net operating loss for the loss year or for any taxable year thereafter,* * * *

and the taxable income so computed shall not be considered to be less than zero.

* * * * *

(c) Net Operating Loss Defined.—For purposes of this section, the term 'net operating loss' means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

(d) Modifications.—The modifications referred to in this section are as follows:

(1) Net Operating Loss Deduction.—*No net operating loss deduction shall be allowed.*" (Italics supplied.)

The City Business Tax (General Corporation Tax)

Subdivision 1 of §R46-3.0 of the Administrative Code of the City of New York provided in pertinent part, with respect to the taxable year involved, 1968, as follows:

"Imposition of tax; exemptions. 1. For the privilege of doing business in the city in a corporate or organized capacity for all or any part of each of its fiscal or calendar years, every domestic or foreign corporation, except corporations specified in subdivision four of this section, shall annually pay a tax, upon the basis of its entire net income, * * *."

Subdivision 8 of §R46-2.0, which defines "entire net income", reads in pertinent part as follows:

"'Entire net income' means net income from all sources which shall be *the same as the taxpayer's federal taxable income computed without regard to any election under subchapter s of chapter one of the internal revenue code,* except as hereinafter provided, and subject to any modification required by paragraphs (d) and (e) of subdivision three of section R46-4.0 of this part.

(a) Entire net income shall not include:

(1) income, gains and losses from subsidiary capital which do not include the amount of a recovery in respect of any war loss;

(2) fifty per centum of dividends other than from subsidiaries;

(3) bona fide gifts;

(4) income and deductions with respect to amounts received from school districts and from corporations and associations, organized and operated exclusively for religious, charitable or educational purposes, no

part of the net earnings of which inures to the benefit of any private shareholder or individual, for the operation of school buses; and

(5) any refund or credit of a tax imposed under this part, for which tax no exclusion or deduction was allowed in determining the taxpayer's entire net income under this part for any prior year;

(b) Entire net income shall be determined without the exclusion, deduction or credit of:

(1) the amount of any specific exemption or credit allowed in any law of the United States imposing any tax on or measured by the income of corporation,

(2) any part of any income from dividends or interest on any kind of stock, securities or indebtedness, except as provided in clauses one and two of paragraph (a) hereof,

(3) taxes paid or accrued to the United States [or the state] on or measured by profits or income or to the state under article nine or nine-a of the tax law.

(4) taxes imposed under this part,

(5) ninety per centum of interest on indebtedness directly or indirectly owed to any stockholder or shareholder (including subsidiaries of a corporate stockholder or shareholder), or members of the immediate family of an individual stockholder or shareholder, owning in the aggregate in excess of five per centum of the issued capital stock of the taxpayer, except that such interest may, in any event, be deducted

(A) up to an amount not exceeding one thousand dollars,

(B) in full to the extent that it relates to bonds or other evidences of indebtedness issued, with stock, pursuant to a bona fide plan of reorganization, to persons, who, prior to such reorganization, were bona fide creditors of the corporation or its predecessors, but were not stockholders or shareholders thereof,

(C) in full where the investment allocation percentage is applied to entire net income, and

(D) in full to the extent that it is paid to a federally licensed small business investment company;

(6) in the discretion of the director of finance, any amount of interest directly or indirectly and any other amount directly attributable as a carrying charge or otherwise to subsidiary capital or to income, gains or losses from subidiary capital; and

(7) any amount by reason of the granting, issuing or assuming of a restricted stock option, as defined in the internal revenue code of nineteen hundred fifty-four, or by reason of the transfer of the share of stock upon the exercise of the option, unless such share is disposed of by the grantee of the option within two years from the date of the granting of the option or within six months after the transfer of such share to him;

* * * * *

(f) A net operating loss deduction shall be allowed which shall be the same as the net operating loss deduction allowed under section one hundred seventy-two of

the internal revenue code or which would have been allowed if the taxpayer had not made an election under subchapter s of chapter one of the internal revenue code, except that (1) any net operating loss included in determining such deduction shall be adjusted to reflect the inclusions and exclusions from entire net income pursuant to paragraphs (a), (b), (g) and (h) hereof, (2) such deductions shall not include any net operating loss sustained during any taxable year in which the taxpayer was not subject to the tax imposed by this part, and (3) such deduction shall not exceed the deduction for the taxable year allowable under section one hundred seventy-two of the internal revenue code, or the deduction for the taxable year which would have been allowable if the taxpayer had not made an election under subchapter s of chapter one of the internal revenue code;

(g) At the election of the taxpayer, a deduction shall be allowed for expenditures paid or incurred during the taxable year for the construction, reconstruction, erection or improvement of industrial waste treatment facilities and air pollution control facilities.

* * * * *

(h) With respect to gain derived from the sale or other disposition of any property acquired prior to January first, nineteen hundred sixty-six; which had a federal adjusted basis on such date (or on the date of its sale or other disposition prior to January first, nineteen hundred sixty-six) lower than its fair market value on January first, nineteen hundred sixty-six or the date of its sale or other disposition prior thereto, except property described in subsections one and four

of section twelve hundred twenty-one of the internal revenue code, there shall be deducted from entire net income, the difference between—

(1) the amount of the taxpayer's federal taxable income, and

(2) the amount of the taxpayer's federal taxable income (if smaller than the amount described in (1) computed as if the federal adjusted basis of each such property (on the sale or other disposition of which gain was derived) on the date of the sale or other disposition had been equal to either (A) its fair market value on January first, nineteen hundred sixty-six or the date of its sale or other disposition prior to January first, nineteen hundred sixty-six, plus or minus all adjustments to basis made with respect to such property for federal income tax purposes for periods on and after January first, nineteen hundred sixty-six or (B) the amount realized from its sale or disposition, whichever is lower; provided, however, that the total modification provided by this paragraph (h) shall not exceed the amount of the taxpayer's net gain from the sale or other disposition of all such property." (Italics supplied.)

The lettered paragraphs of subdivision 8 provide for certain modifications of federal taxable income. We are here primarily concerned with the modifications provided by paragraph (f), *supra*, pp. 12-13.

Subdivision 8 of §R46-1.0 of the Administrative Code reads as follows:

"8. Unless a different meaning is clearly required, any term used in title shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, and any reference to the laws of the United States shall mean the provisions of the internal revenue code of nineteen hundred fifty-four, and amendments thereto, and other provisions of the laws of the United States relating to federal income taxes, as the same are included in the appendix to this title. (The quotation of the aforesaid laws of the United States is intended to make them a part of any appropriate title and to avoid constitutional uncertainties which might result if such laws were merely incorporated by reference. The quotation of a provisions* of the federal internal revenue code or of any other law of the United States shall not necessarily mean that it is applicable to or has relevance to any of the titles.)"

The appendix referred to in subdivision 8 sets forth Internal Revenue Code §172 *in haec verba.*

Title R of the Administrative Code, including its appendix, are in substance the same as the model law and its appendix set forth in the State enabling legislation pursuant to which the City tax law was enacted (L. 1966, c. 772).

The adjustment of the net operating loss referred to in paragraph (f) to reflect the inclusions and exclusions from entire net income made by paragraphs (a), (b), (g) and (h) of subdivision 8, may increase or decrease the net operat-

* So in original.

ing loss deduction taken in ascertaining that "entire net income." If these adjustments result in a net increase of the net operating loss deduction, that deduction may exceed the federal deduction, so that provision is made in paragraph (f) to limit the adjusted loss to the federal figure. Among those modifications which may increase the loss deduction, are those provided by paragraphs (a), (g) and (h) of subdivision 8. Paragraph (a), *supra*, pp. 10-11, decreases gross income and, hence, increases any loss by excluding, among other things, certain income from subsidiaries and school districts [subparagraphs (1) and (4)]. Paragraph (g), *supra*, p. 13, may increase the loss deduction by allowing a deduction for the entire cost of waste treatment or anti-pollution facilities. Paragraph (h), *supra*, pp. 13-14, decreases gain or income by increasing the cost basis of property to its 1966 value, which, if greater than the federal cost basis, decreases income and increases the net loss.

Subdivision 5 of Administrative Code §R46-3.0, the imposition section, provides that "[t]he tax imposed * * * is imposed for each calendar or fiscal year beginning with calendar or fiscal years ending in or with the calendar year nineteen hundred sixty-six." Thus, the debtor first became "subject to the tax imposed" for its fiscal 1965-1966.

Subdivision 3 of §R46-5.0 of that Code reads as follows:

> "3. If the amount of taxable income for any year of any taxpayer, or of any shareholder of any taxpayer which has elected to be taxed under subchapter s of chapter one of the internal revenue code, as returned to the United States treasury department or the New York state tax commission is changed or corrected by the commissioner of internal revenue or other officer of the United States or the New York state tax commis-

sion or other competent authority, or where a renegotiation of a contract or subcontract with the United States or the state of New York results in a change in taxable income, or where a recovery of a war loss results in a computation or recomputation of any tax imposed by the United States or the state of New York, or if a taxpayer or such shareholder of a taxpayer, pursuant to subsection (d) of section sixty-two hundred thirteen of the internal revenue code, executes a notice of waiver of the restrictions provided in subsection (a) of said section or if a taxpayer or such shareholder of a taxpayer, pursuant to subdivision (f) of section one thousand eighty-one of the New York tax law, executes a notice of waiver of the restrictions provided in subdivision (c) of said section, such taxpayer shall report such changed or corrected taxable income, or the results of such renegotiation, or such computation, or recomputation, or such execution of such notice of waiver and the changes or corrections of his federal or New York state taxable income on which it is based, within ninety days after such execution or the final determination of such change or correction or renegotiation, or such computation, or recomputation or on its next report under this part, or as required by the director of finance, and shall concede the accuracy of such determination or state wherein it is erroneous. Any taxpayer filing an amended return with such department shall also file within ninety days thereafter an amended report with the director of finance."

Paragraph (c) of subdivision 3 of §R46-64.0 of that Code reads as follows:

"(c) Report of changed or corrected federal or New York state income.—In the case of the tax imposed under part two or part three of this title, if the taxpayer files a report or amended return required thereunder, in respect of an increase in federal or New York state taxable income or federal or New York state tax, or in respect of a change or correction or renegotiation, or in respect of the execution of a notice of waiver report of which is required thereunder, or computation or recomputation of tax, which is treated in the same manner as if it were a deficiency for federal or New York state income tax purposes, the assessment (if not deemed to have been made upon the filing of the report or amended return) may be made at any time within two years after such report or amended return was filed. The amount of such assessment of tax shall not exceed the amount of the increase in city tax attributable to such federal or New York state change or correction or renegotiation, or computation or recomputation of tax. The provisions of this paragraph shall not affect the time within which or the amount for which an assessment may otherwise be made."

The Opinion Below

The Court below held that the net operating loss allowed by the City law need not be based upon the figures and years shown in the federal return for the same taxable period but that, since the year from which a loss was carried over as a net operating loss deduction in the federal return (the loss for the year 1963) was excluded by the provisions of Administrative Code §R46-2.0, subd. 8, par. (f), which

bars losses for years during which the taxpayer was not subject to the City tax, the loss for a later year, 1966 or 1969 or 1970, during which the taxpayer was subject to the City tax, might be substituted for the excluded year's loss. Such a substitution, the Court said, would best effectuate the "legislative intent in adopting a carryforward and carryback loss provision, *i.e.*, to allow an averaging of income over a number of years" (55a).

The Court agreed that the City law's definition of "entire net income" as "the same as the taxpayer's federal taxable income", included the federal loss deduction calculated pursuant to §172 of the Internal Revenue Code (56a) and "requires, at least initially, the use of the figures *reported* on the federal return" (60a). But it went on to say somewhat cryptically that "[t]he mere fact, however, that the *reported* figures must be the same does not *ipso facto* mandate that their *application* be the same" (61a). Citing the District Court case of *Brandon* v. *United States*, 204 F. Supp. 912 (N.D. Ga. 1962), it stated that "[i]f for some reason a taxpayer chose not to apply a reported loss from a qualifying year as a deduction on his federal return there is no reason why he would not be permitted to apply a different loss from another qualifying year as a deduction under §172" (61a). As a consequence, it reasoned, that "Avien's post-January 1, 1966* and 1969 and 1970 losses are losses which are 'allowed' under §172 and consequently

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* There was testimony of dubious quality showing that there was sufficient loss in the portion of fiscal 1966 falling in calendar 1966 to fill part of the gap caused by the exclusion of the prior unusable losses (28a-29a). We concede that if any loss may be substituted for the excluded 1963 loss, the whole of the fiscal 1966 loss may be considered because the taxpayer was subject to tax for a fiscal year ending in 1966. Admin. Code §R46-3.0(5), *supra*, p. 16.

may be used as deductions against City income under §2.0 (8)(f)" (61a).* The Court suggested (*Id.* f.n. 5) that an appropriate amendment of the federal return might work the substitution but held this to be unnecessary. This aspect of the Court's holding sets a precedent applicable to federal income tax cases as well as the State and City corporate income taxes.

The Court went on to point out that the provision of paragraph (f) of Administrative Code §R46-2.0, subdivision 8, which limits the loss deduction to that "allowable under section one hundred seventy-two" would be superfluous if the City law required the use of the identical federal figures (61a-62a). In this reasoning, the Court seems not to have realized that the limitation is on the deduction after it is adjusted and modified and, hence, possibly increased, and not on the initial loss deduction.

The remaining portion of that part of the opinion which deals with the questions raised here** consists of a series of rebuttals of the various arguments made in our District Court brief in support of the constructions which we sought there and now seek in this Court. Since we shall reiterate those arguments in this brief, we shall discuss the opinion's attempts to counter them in the argument which follows.

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* The reference is, of course, to §R46-2.0(8)(f).

** Another question relating to the failure of the debtor to prove its 1966 and later years' losses was raised by the City below. We neither agree nor quarrel here with the disposition of that question by the Court below.

ARGUMENT

The net operating loss deduction for the City tax is the federal deduction modified by the provisions of paragraph (f) of subdivision 8 of Section R46-2.0 of the Administrative Code. That subdivision requires the use of the same loss year or years which may be used in the calculation of the federal income tax with the elimination of those of them during which the taxpayer was not subject to City tax. Section 172 of the Internal Revenue Code requires that the federal net operating loss deduction be calculated by carrying back or over the loss of any eligible year in its chronological order and does not allow the carrying of a given year's loss until the losses of earlier years have been fully utilized or become ineligible for carryback or carryover.

(1)

The United States Supreme Court stated in *Deputy* v. *duPont*, 308 U.S. 488, 493 (1939), that "allowance of deductions from gross income does not turn on general equitable considerations. It 'depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed'. *New Colonial Ice Co.* v. *Helvering*, 292 U.S. 435, 440." The City tax law has allowed a deduction for a net operating loss in its definition of "entire net income." The question with which we are faced is the extent of that allowance and the manner of its modification and calculation.

The right of a corporate taxpayer to a net operating loss deduction under the City law derives from the first paragraph of subdivision 8 of §R46-2.0 of the Administra-

tive Code, the definition of "entire net income." That definition states that, except as modified by later paragraphs, entire net income "shall be the same as the taxpayer's federal taxable income." Since federal taxable income is defined by §63(a) of the Internal Revenue Code as "gross income minus the deductions allowed by this chapter" and since one of the deductions allowed by "this chapter" (Chapt. 1) is the net operating loss deduction provided by Internal Revenue Code §172, the right to a net operating loss deduction inheres in the preliminary definition of "entire net income." When subdivision 8 says that "entire net income" shall be the same as federal taxable income, it does not mean, as the Court below held, that it is not really "the same as * * * federal taxable income", but that it is something other than federal taxable income and is merely based on or generally guided by the principles by which federal taxable income is derived (60a). It means the same income. If it were construed to mean that "entire net income" could be computed as different from that appearing on the taxpayer's federal return so long as it followed the Internal Revenue Tax Code's guidelines or principles, the whole structure of the City tax, which is based on a premise of conformity with the federal law, would be destroyed. It would be different from and not the same as federal taxable income. For example, under such an interpretation of the words "the same as", a taxpayer which in its federal return elected to take a credit against tax for foreign taxes paid, instead of deducting those taxes from gross income, as it is permitted to do under §901(a) of the Internal Revenue Code, could nevertheless deduct those foreign taxes in computing his City "entire net income." [See I.R.C. §275(a)(4).] No such foreign tax credit is allowed against the City tax. Or, a taxpayer who in his federal return used

a straight line method of depreciation under Internal Revenue Code §167(b)(1), would be free, in his City return, to use the declining balance method under §167(b)(2), or the sum of the years-digits method under paragraph (3) of subsection (b) of that section. Yet the Court below, in curious conflict with its notion that the City law's reference to §172 of the Code is merely "for general guidance" (60a), agreed that "if a particular method of depreciation is employed in the calculation of federal taxable income, that same method must be used in computing City taxable income" (60a-61a). Numerous other options under the federal law could be elected to taxpayer's advantage, but ignored if ignoring gave a tax advantage under City law. A corporation planning to move out of the City could elect to deduct all its research expenses or its circulation expenses in its final City return while capitalizing and amortizing them for its continuing federal tax purposes (I.R.C. §173 and §174. See I.R.C. §263). There is little point in detailing the other similar optional methods of treatment found throughout the Internal Revenue Code; those discussed amply illustrate the point we make here, namely, that "the same as the taxpayer's federal taxable income" means just that and does not mean "the same as" federal taxable income computed by using the Internal Revenue Code "for general guidance" (60a) and as a *vade mecum* of general principles.

Paragraph (f) of subdivision 8 of §R46-2.0, *supra*, pp. 12-13, is one of a number of paragraphs designed to modify federal taxable income and is specifically designed to modify the federal net operating loss deduction. It reiterates the right to that deduction already given by the preliminary definition of "entire net income", but it adjusts (increases or decreases) the federal figures by certain inclusions and exclusions provided by paragraphs (a), (b), (g) and (h)

of subdivision 8, and by excluding from the federal figures any losses attributable to taxable years in which the taxpayer was not subject to City tax. Nowhere does it say that a taxpayer may substitute other loss years for those of the loss years excluded from the federal deduction. The District Court permitted substitution of another loss year not involved in the federal return on the theory that the words "the same as" in paragraph (f) meant that the operating loss deduction need only be determined along principles and guidelines laid down by the Internal Revenue Code (60a). Yet the same words, *i.e.* "the same as", when used in the initial paragraph of subdivision 8 of Administrative Code §R46-2.0, were seemingly construed by that Court to require the identical figures of the federal tax calculation when it came to the depreciation deduction (60a-61a).

(2)

The District Court's holding that reference in Administrative Code §R46-2.0(8)(f) to I.R.C. §172 is merely for purposes of guidance (60a) is especially anomalous when we consider that the precise verbiage of I.R.C. §172 is contained in the City Tax Law itself. Section R46-1.0 of the City's Administrative Code (*supra*, pp. 14-15) not only incorporates most of the language of the income tax sections of the Internal Revenue Code but the texts of those sections, including §172, are included *in haec verba* in an appendix to Title R of the City Code, which is a part of Title R, the title imposing the general corporation tax. That appendix is part of the City law enacted by Local Law No. 21 of 1966 and of the model law set forth in the enabling act, on which the City law is based. Actually, the City law contains all of the language of I.R.C. §172 which it repeats as part of the local law.

(3)

The resolution of the issue at bar calls for analysis of intricate and complicated federal statutory language. This requires a very close scrutiny of that language and a careful and complete analysis of its purport in order to arrive at its proper interpretation.

We believe that the Court below fell into multiple error as a result of its incomplete, cursory and faulty analysis of both the City law and the federal provisions.

In holding that the City law did not require the use of "the identical loss used on the federal return" (61a) before adjustment, the Court adverted to that part of Administrative Code §R46-2.0(8)(f), which provides that the City net operating loss deduction "shall not exceed the deduction * * * allowable under section one hundred seventy-two". It stated that "[i]f the identical loss must be used, obviously it could not be greater than itself" (62a) and that therefore the limiting language "would be superfluous" if such identity were required (61a-62a). This piece of logic is based upon a false premise, namely that the limitation is on the amount of the federal loss figures.

The language is not at all superfluous because it does not limit the initial federal loss, *i.e.*, the identical loss. It is necessary because it limits the City loss after the federal figure has been increased by required adjustments and the City deduction exceeds the federal figure (see pp. 15-16, *supra*).

After starting with the identical federal loss figure, §R46-2.0(8)(f) provides that each of the years making up the federal loss deduction:

> "shall be adjusted to reflect the inclusions and exclusions from entire net income pursuant to paragraphs

(a), (b), (g) and (h) hereof * * * and (3) such deduction shall not exceed the deduction * * * allowable under section one hundred seventy-two."

When the adjustments made to the loss years pursuant to paragraphs (a), (b), (g) and (h) are made, they may result in a net increase or decrease in the amount of the federal deduction which is used as the starting point for calculating the City deduction. If such is the case, the limiting language which the Court said would be superfluous, places a ceiling on the amount of the City deduction. In short, the net of the adjustments may not increase the federal loss deduction, although it may decrease it. *

For example, paragraph (a) (*supra*, pp. 10-11) excludes from income, among other things, "income, gains and losses from subsidiary capital * * * " and "income and deductions with respect to amounts received from school districts * * * for the operation of school buses * * * ." If a corporation having a federal loss deduction of $100,000, had during the only year entering into the calculation of the net operating loss deduction, gains from subsidiary capital of $25,000 and net income from school bus operations of $25,000, and no other adjustments, its federal loss figure after paragraph (a) adjustments excluding those gains and that income, would be increased to $150,000. The limiting language of paragraph (f) would restrict the City deduction to the amount of the federal deduction; *i.e.*, $100,000. Thus,

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* Although out of immediate context, it should be observed that if the District Court is correct, a taxpayer with a loss for a year which is carried to its taxable year in the federal return, but which after adjustments under paragraph (b) of subdivision 8, *supra*, pp. 8-9, is reduced or entirely eliminated, could substitute another "qualifying" loss year in its City return, a year in which the adjusted loss was greater, and thus frustrate the purpose of the required adjustments.

the language is anything but superfluous, even though the precise federal loss figure is used initially to compute the City loss deduction.

The same kind of faulty analysis which the District Court applied to the City statute permeates another important area of its reasoning in which the statutory material involved, I.R.C. §172, is far more complex and intricate than the rather clear language and purport of the City operating loss provisions. We proceed to discuss that area.

(4)

The District Court seized upon the use of the phrase in §R46-2.0(8)(f), of the Administrative Code, "a net operating loss shall be *allowed* which shall be the same as the * * * deduction *allowed* under section one hundred seventy-two" (61a). It reasoned that had the City law meant to confine the unadjusted loss to that of the federal return the draftsmen would have used, instead of the word "allowed", the phrase "actually taken under section 172" (61a), and that substitution of a later year for the one barred from use by the City law is "allowed" by I.R.C. §172 (*ibid.*).

This reasoning is even more egregiously erroneous and lacking in careful analysis than the Court's faulty analysis of the effect of the provision limiting the City loss deduction to the amount of the federal loss deduction. It is quibbling to point out that the suggested phrase, "actually taken", might confine the City deduction to the amount taken on the taxpayer's return or refund claim, regardless of its correctness. The suggested language could readily be refined to read "properly taken." But it is far from a quibble to assert that the Court's reasoning which inter-

prets I.R.C. §172 as allowing a substitution or use of any year's loss so long as it is incurred no more than three years after or five years before the taxable year to which it is carried, is demonstrably erroneous.

Such random choice of loss year is neither contemplated, allowed nor permissible under I.R.C. §172. That this is so is made clear from a careful (albeit sometimes tedious and painstaking) analysis of the provisions of paragraph (2) of subsection (b) of that section (*supra,* pp. 8-9), which provides that:

> "* * * the entire amount of the net operating loss for any taxable year (hereinafter in this section referred to as the 'loss year') shall be carried to the earliest of the taxable years to which (by reason of paragraph (1)) such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried. For purposes of the preceding sentence, the taxable income for any such prior taxable year shall be computed—
>
> * * * * *
>
> (B) by determining the amount of the net operating loss deduction—
>
> (i) without regard to the net operating loss for the loss year or for any taxable year thereafter, * * *."

The paragraph plainly states that the net operating loss for any year "shall be carried to the earliest of the taxable

years to which * * * such loss may be carried." * It does not say that such a loss "may" be carried, but that it "shall"; *i.e.*, "must" be carried, if it may be carried, to that earliest year. Thus, a loss for the year 1975 must first be carried back three years to 1972 to the extent that there was taxable income in that year, because in such a case it may be carried to that year. If the 1975 loss exceeds the 1972 income, the excess over the 1972 income must be carried to the earliest year to which it may be carried, that is, 1973, if 1973 yielded a net income. While §172 does not expressly state that the excess shall or must be carried to the earliest year to which it may be carried, that conclusion is inescapable because (1) that excess is part of "the entire amount of the net operating loss for any taxable year" which shall be so carried; and (2) §172 defines that excess as "the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried." Thus, in defining that excess, it assumes that the part of the loss which was used up was carried to a prior year or years, each of which was at the time, the earliest year to which it may have been carried. Moreover, subparagraph (B) of paragraph (2) (p. 9, *supra*) also provides that the taxable income for the prior taxable years which must be deducted to determine the portion of a given year's loss which constitutes the excess, shall be computed "without regard to the net operating loss for the loss year or for any taxable year thereafter * * * ." That "taxable income" is computed by deducting operating

* Neither of the two opinions below deals with the decisive significance of this language. Instead, although counsel stressed it at the hearing (38a), the opinion of the Bankruptcy Judge omits it when he purports to quote the "pertinent part" (47a) of §172 (48a-49a).

losses from prior years but not from the loss year or any later year. The reason for this is that the losses from years prior to the loss year are required to be used up before any of those of the loss year or later years are used. Consequently, only that portion of the loss year's deficit which is needed to reduce taxable income to zero is used and the balance becomes the excess portion which may be carried to other later taxable years. Thus, in the example given above at page 29, if before the 1975 loss is carried back to 1972, that year's taxable income was $100,000, arrived at by deducting a $50,000 1974 loss (or its remaining portion) from actual 1972 income of $150,000, any excess of the 1975 loss above $100,000 would have to be carried back to 1973 and/or carried forward.

Since a 1975 loss sufficient to reduce both 1972 and 1973 incomes to zero, must be carried back to 1972 and 1973, it follows that the loss of a later year, *e.g.*, 1976, cannot be carried back to 1973 for there remains no more taxable income in 1973 to be reduced by the 1976 loss. Consequently, if a loss or unused portion must be carried back to the earliest year to which it may be carried, it follows that net operating losses must be carried back or forward in chronological order.

Put another way, since a later loss does not exist or accrue until after a prior loss has accrued, and since that prior loss must be carried to the earliest permissible year after it has accrued, the later loss cannot possibly be carried anywhere until all prior losses which may be carried have been used.

In the instant case, the Court below held that federal law allowed in 1968 the deduction of losses of years later than 1963 (61a) even though a portion of the 1963 year's

loss remained unused. In our view, since there remained an unused portion of the 1963 loss (22a) [presumably $19,745.79 was carried to earlier taxable years (54a, 22a)], that portion had to be carried over to the 1968 federal return (22a). When carried over to that return, only $286,969.82 of its total of $742,677.94 was used. Since the City law was enacted in and applied only to 1966 and later years, the taxpayer was not subject to the City tax in 1963 and the loss for that year could not be included in its City net operating loss deduction.

(5)

The Court below, in support of its holding that I.R.C. §172 gave the taxpayer a choice of loss years and of the order in which they might be carried, cited (61a) the only authority which appears to support that holding, *Brandon* v. *United States,* 204 F. Supp. 912 (N.D. Ga. 1962), noting that it was contrary to the view of the Internal Revenue Service in Rev. Ruling 218, 53-2 Cum. Bull. 176. (*Ibid.*) Both the *Brandon* case and the Revenue Ruling dealt with §122 of the Internal Revenue Code of 1939, the predecessor and source of §172 of the 1954 Code.

In the *Brandon* case, the Court permitted 1954 and 1955 losses to be carried back to 1953 even though the taxpayer had a 1952 loss which would have eliminated the 1953 income but which the taxpayer failed to take. The Court treated the case as one of first impression and simply said that "[n]o statute or decision of the courts is cited" (264 F. Supp. at p. 913) to support the Government's claim. It also stated that it found "no decision or statute sustaining this decision" (*ibid.*) nor "any language in the Internal Revenue Code of 1939 which controls this matter" (*ibid.*).

No reference is made to Revenue Ruling 218, *supra,* so that it does not appear whether it was cited by government counsel.

The 1939 Code in its §122 did not contain the specific and explicit language used in I.R.C. §172(b)(2), requiring any loss to be carried to "the earliest of the taxable years to which * * * such loss may be carried." This may explain why the Court in the *Brandon* case had difficulty in finding language to support such a requirement. Revenue Ruling 218-53, *supra,* was not, nor could it have been, based on such language. But while we might wish it were otherwise, so that we could reconcile the *Brandon* case result with our contention by simply assuming that the rule was different under the 1939 Code and that, therefore, the Court below followed a wholly inapplicable precedent, the fact is that the 1939 provision effectively dictated a similar result even though it did not do so in language quite so explicit and clear as that of the 1954 Code. In the provisions applicable to the years involved in *Brandon,* Internal Revenue Code of 1939, §122(b)(1)(B) provided a loss carryback to the one preceding taxable year.* Subparagraph (B) of paragraph 2 of subdivision (b) provided a loss carryover for the five years succeeding the loss year and provided:

> "that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed—
>
> * * * * *

---

* The two-year carryback of a 1955 loss to 1953 in *Brandon* would have been permitted by the transitional provisions of the 1954 Code, §172(g)(2)(A) if the 1952 loss had not existed.

(ii) by determining the net operating loss deduction for each intervening taxable year, without regard to such net operating loss or to the net operating loss for any succeeding taxable year * * * .

For the purpose of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1949, shall be reduced by the amount, if any, of the net income for the preceding taxable year * * * ."

In the light of this language, it seems clear that the 1939 Code provisions contemplated the carrying of a loss to the first year to which it could be carried and, hence required chronological order in the carrying of net operating losses to other years.

Indeed, this is the interpretation placed by this Court on the analogous provisions of §122 of the 1939 Code, relating to losses for years beginning before 1950, in *Phoenix Coal Co.* v. *Commissioner of Internal Revenue,* 231 F.2d 420 (2nd Cir., 1956). We discuss the *Phoenix* case in detail, *infra,* pp. 34-35.

We think the *Brandon* case is unsound and that counsel's failure to cite (204 F. Supp. at p. 913) and the Court's failure to find in (*ibid.*) the 1939 Code the above language which required chronological order in deducting losses, was unfortunate.

Other cases and authorities, including the decision of this Court in *Phoenix Coal Co.* v. *Commissioner of Internal Revenue,* 231 F.2d 420 (2d Cir. 1956), and other Revenue Rulings are in clear conflict with the Georgia District Court's opinion.

Rev. Rul. 96, 1 Cum. Bull. 65-126; Rev. Rul. 285, 1 Cum. Bull. 56-134;

5 MERTENS, Law of Federal Income Taxation, §§29.02 and 29.02d;

LASSER, Loss Carryovers Under the Internal Revenue Law, 33 Cornell L.Q. 50, 52-53 (1947).

We believe that this Court's holding in the *Phoenix* case is correct and controlling. The essence of the *Phoenix* holding and its companion cases is that when the federal income tax law allows a deduction, in the absence of special provision for its waiver, that deduction must be taken and considered whenever the year to which it relates is under consideration. This holding is squarely in point in our situation when we assert that a net operating loss for a given year which must be carried to the earliest year to which it may be carried cannot be waived and replaced by a loss for a later year. In *Phoenix,* part of a 1947 loss was used "to wipe out net income in 1945" (231 F.2d at p. 421) and the excess carried to 1946. Although assessment of a 1945 deficiency would have been time-barred, the Commissioner of Internal Revenue disallowed certain other deductions taken in that year and applied more of the 1947 loss to counterbalance them. This reduced the excess portion of the 1947 loss, previously carried to 1946, resulting in a deficiency for 1946, the year in issue. This Court held that the statute of limitations did not bar readjustment of the 1945 income because (1) there was no 1945 deficiency since part of the excess portion of the 1947 loss which had been deducted in 1946 had to be used to wipe out the increased income of the earliest possible year to which it could be carried, 1945 and (2) "the limitation statute * * * refers to the return in question, i.e., the 1946

return, not the 1945 return" (*ibid.*). Accordingly, it was held that a deficiency resulted for 1946 due to the required shifting of the part of the 1947 loss from that year back to 1945.

This Court cited as "directly in point" (*ibid.*) its earlier holding in *Commissioner of Internal Revenue* v. *Van Bergh*, 209 F.2d 23 (2d Cir., 1954), where although deficiency for 1945 was time barred, that year's income was corrected in determining a timely claim for refund based on a loss carryback.

The *Phoenix Coal Co.* decision was followed by the Court of Claims in *Springfield Street Railway Co.* v. *United States*, 312 F.2d 754 (Ct. Cl., 1963). In that case the taxpayer was allowed to recompute its 1953 income, refund of which was time-barred, by increasing its deductions for that year and thus to increase the portion of a 1955 loss carryback to be carried to 1954 for which year refund was sought. In the course of its opinion, the Court said (p. 754):

> "The carryback loss must first be applied against 1953 income.[1] If any loss remains, it may then be applied against 1954 income."

The footnote cited I.R.C. §172.

And, later (p. 755):

> "Although 1953 was closed by the statute of limitations for refund purposes, plaintiff first had to carry back the loss to that year. Any loss remaining then, after wiping out 1953 income, could be carried back to 1954."

(6)

The State of New York has a problem similar to ours. Section 208 of the New York Tax Law, subdivision 9, paragraph (f), the analogue of Administrative Code §R46-2.0 (8)(f), bars losses for taxable years prior to January 1, 1961, or any year for which the taxpayer was not subject to the tax. The State Tax Commission has held that losses from years not used in the federal return cannot be substituted for disallowed years.

Matter of Savin Business Machine Corporation, C.C.H. N.Y. Tax Serv. (Transfer Binder 1968-1971), par. 99-281 (1971); *Matter of Advance Biofactures Corporation,* 3 C.C.H., N.Y. Tax Serv., par. 99-509 (1972); *Matter of Hi-Lo Food Centers, Inc.,* C.C.H. N.Y. Tax Serv. (Transfer Binder 168-1971), par. 99-240 (1970); *Matter of Innersprings Inc., id.* par. 99-405 (1971). See also, *Matter of Vision Associates, id.* par. 99-236 (1970).

(7)

This case involves a corporation which has had financial difficulties. It is conceivable that the losses which it seeks to take here may never be usable. As the Bankruptcy Judge put it "the debtor is damned if he does and damned if he doesn't." (49a) He also looked upon the City's construction as "draconian law whereby the debtor is * * * proffered an impotent remedy" (*ibid.*). He seems to have lost sight of the fact that we are dealing with a provision of law which applies to corporations other than those in protracted financial difficulties. The loss which may not be substituted for that barred by the City's statute may very well be usable in a later year. Take, for example, a corporation having losses of $1,000 in three successive years, the

first of which was for the year 1965 when there was no City tax. In 1968, assume it has federal income of $2,000 before deduction of any loss. Its net operating loss deduction for that year is $2,000, consisting of the 1965 and 1966 losses. It therefore has no federal taxable income. But its City taxable income is $1,000 because it has to exclude the 1965 loss. If the debtor's position were correct, it would have no City income because it could substitute its 1967 loss and thus reduce its entire net income to zero. In not permitting this substitution, the City is not denying the use of the 1967 loss. For if in 1969 the corporation has income of $2,000 before loss carryover, its federal income will be zero by reason of carrying over the 1967 loss and that 1967 loss will be usable in reducing its City income to zero. Thus, the 1967 loss, which was not permitted to be substituted for the barred 1965 loss, is eventually used.

Moreover, if we were to follow the debtor's position and allow that 1967 loss to be substituted in the 1968 return, what would happen in the 1969 City return? Since it took that 1967 loss in its 1968 City return, could the taxpayer take it again in the City 1969 return? Actually, on the face of the statute, it could. The interpretation of the City and federal statutes sought by the debtor and adopted by the Court below thus makes a mishmash of the conformity with federal law which is the basic design of the New York State and City statutes, or perverts the obvious design of the federal law. It not only results in an anomalous situation for the year in which a given loss is substituted for one which is disallowed, but it also fouls up the calculation of the loss deduction in later years.

(8)

In determining the meaning of a provision of the City tax law and the intent of those who drafted it, one cannot focus upon an isolated provision of that law to the exclusion of all of its other provisions. The overall design of the City tax law provides further evidence that New York City "entire net income" is to be tied in precisely with the federal return, albeit with the modifications provided by subdivision 8 of §R46-2.0 of the Administrative Code.

The definition of "entire net income" which, before modification, is the same as federal taxable income, is one *indicium* of the intent of the lawmakers. But other provisions show too, that the administration of the tax is so tied in with the federal return that, except for the deviations required or permitted by the statute and except for the allocation of the income provided by it (Adm. Code §R46-4.0), adherence to the federal tax return is mandatory.

The most important of these provisions is subdivision 3 of §R46-5.0 of the Administrative Code, *supra,* pp. 16-17, which provides that any taxpayer whose taxable income for any year is changed or corrected by the federal taxing authorities shall report that change and notify the City authorities of it. The three-year statute of limitations for the determination of a deficiency of tax for that year is extended by Administrative Code §R46-64.0, subdivision 3, paragraph (c), *supra,* pp. 17-18, for an additional two years after the report of a change in federal income. These provisions are of enormous help to the City taxing authorities because they enable them to rely to a great extent on federal examinations and determinations instead of undertaking an extensive program of enforcement and audit them-

selves. See *Peo. ex rel. Hazzard* v. *Gilchrist,* 220 App. Div. 362 (3d Dept., 1927). The federal government, with a far greater amount of corporate income tax at stake than either the City or State and far greater examining resources, is a primary and vital source of information for both City and State.*

If we assume, as we must in the light of these provisions, that one of the objectives of the draftsmen of the law was to utilize federal examinations and audits and avoid or minimize the administrative costs entailed in extensive local auditing, the interpretation placed on the law by the debtor and the Court below would substantially frustrate that objective.

A short and simple example will illustrate the difficulty. Corporation A, previously doing business solely in New Jersey, moves to New York City on January 1, 1973. In both 1972 and 1973 it has federal net operating losses, each in the amount of $100,000. In 1974 it has income before net operating loss deduction of $100,000. In its 1974 federal return, it deducts the $100,000 loss incurred in 1972. Since it was not doing business in New York in 1972, it cannot deduct that loss in its New York City 1974 return. Instead, it substitutes and deducts the $100,000 loss for 1973 in that return. The federal government examines the taxpayer's 1972 and 1974 returns and makes no changes for either year. It may or may not examine the year 1973 until the taxpayer seeks a carryover of that year's loss. But if it does,

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* The requirement of notice of federal changes has been part of the State corporation tax law from the time Article 9A was added by L. 1917, Chapter 726, which added former Section 219-d to the Tax Law.

and disallows a part of the loss which was carried over in the City return, the disallowance does not affect the federal 1974 return. Hence, there is no change in that return and no requirement to notify the City. Likewise, because no notice is required for 1974, there is no extension of the City's time to assess a 1974 deficiency. If the City were required to substitute the 1973 loss for the disallowed 1972 loss, it would itself have to make the audit for which it normally relies on the federal government and would have to do it very promptly. Thus, one of the most important objectives of the City tax law would be thwarted and the City would be compelled to do that which was sought to be avoided by its draftsmen.

We are not complaining about or seeking to avoid the onerous consequences of a ruling which would require more extensive auditing than the City now performs. The City does a certain amount of auditing of factors not entering into the federal return and is equipped to do this limited amount. We are merely pointing out that the structure of the law with its provisions for reporting federal changes points to the interpretation which we claim to be the correct interpretation of the definition of "entire net income" and the treatment of the net operating loss deduction. That structure and the aim of the law is such that federal conformity is its keynote. One of the more cogent reasons for federal conformity is to avoid the task of separate audit of the portions of the taxpayer's return which are reflected in its federal return and which will, in many instances, be subject to federal examination.

In summary, therefore, when a loss year is disallowed because it was not a New York City tax year, no other loss year may be substituted unless it is part of the net

operating loss taken on the federal return. This is shown by the statutory structure of federal conformity itself and buttressed by the proposition that one of the important purposes of the statute's provision for reporting of federal changes is to avoid expensive and expedited auditing at the local level.

CONCLUSION

The order of the District Court and that of the Bankruptcy Judge reducing the tax claim of the City should be reversed and the claim allowed in full.

Dated: August 8, 1975

Respectfully submitted,

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AFFIDAVIT OF SERVICE ON ATTORNEY BY MAIL

State of New York, County of New York, ss.:

Carlos M Rodriguez being duly sworn, says that on the 8 day of August 19 75, he served the annexed Brief of Appellant upon Jules V Spicuzza Esq., the attorney for the Nat Labor Rel Bd herein by depositing a copy of the same, inclosed in a postpaid wrapper in a post office box situated at Chambers and Centre Streets, in the Borough of Manhattan, City of New York, regularly maintained by the government of the United States in said city directed to the said attorney at No 45 Main St Mineola L.I. in the ~~Borough~~ of Out of Town, City of New York, being the address within the State theretofore designated by him for that purpose.

Sworn to before me, this 8 day of August 19 75

Carlos M Rodriguez

LAWRENCE H GARFUNKEL

#24-1370760 - Com Exp 3/30/77

Form 323-50M-721047(72) 346

AFFIDAVIT OF SERVICE ON ATTORNEY BY MAIL

State of New York, County of New York, ss.:

Carlos M. Rodriguez being duly sworn, says that on the 8 day of August 1975, he served the annexed Brief of Appellant upon Kevin J. Woodrow Esq., the attorney for the D.A. Fan herein by depositing a copy of the same, inclosed in a postpaid wrapper in a post office box situated at Chambers and Centre Streets, in the Borough of Manhattan, City of New York, regularly maintained by the government of the United States in said city directed to the said attorney at No. 225 Broadway in the Borough of New York, City of New York, being the address within the State theretofore designated by him for that purpose.

Sworn to before me, this

8 day of August 1975

Carlos M. Rodriguez

LAWRENCE H. CARDUCCI
Notary Public, State of N.Y.
No. 24-4370766 Com. Exp. 3/30/77

Form 323-50M-721047(72) 346